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Capital flight in Latin America

Memo file

RAR has repeatedly explored the subject of capital flight in Latin America and has not been able to arrive at any quantitative estimates of the amounts of private, local capital that may be transferred abroad in a given period of time. We understand that the Inter-American Development Bank may be able to provide estimates of the sums involved in recent years.

The following comments about the qualitative aspects of the capital flight problem may be interesting and useful to you.

Difficulties of obtaining reasonable estimates -- Capital can be transferred in a wide variety of ways, many of which defy detection. In addition to obvious transfers of money through banks into foreign assets and deposit accounts, there are such devices as underinvoicing of exports; nominally commercial transfers to agents abroad, which are really transfers of personal assets; and local purchases of dollars and foreign checks that are held within the country as a hedge against inflation. The latter device is, for example, widely used in Chile. Analysis is made difficult also because the capital transactions of foreign-owned companies are often lumped together with local capital in available compilations of balance of payments data. The policing and exchange controls necessary to keep track of all these forms of capital transfers and to limit clandestine ones, would stifle economic liberalism in trade and exchange policies. They would probably cause an even heavier and long-term exodus of funds like that which occurred when such controls were imposed in Peron's Argentina.

Reasons for capital exports -- Periods of political economic instability usually give rise to an export of local, as well as foreign,capital. Most such money generally returns to the country when conditions improve, and the flight of funds has only a temporary effect. This type of transfer is especially marked when devaluation from a fixed exchange rate is anticipated. In addition, Latin American investors are offered only limited investment opportunities. Since no investor will put all his eggs in one basket, Latin Americans tend to diversify their portfolios by placing some of their money abroad in part for reasons of safety, in part in anticipation of speculative profits. During recent years, some monetary outflows, labelled as flights or local capital, appear to have been transfers of short-term foreign money originally placed in Latin America in search of high interest rates. Such foreign money moves in quickly to capitalize on the interest rates of 35% and upwards that prevail, for example, on installment sales contracts. When an economic slump occurs which limits the public's ability to buy on easy but costly credit terms, this speculative money rushes out of the country. This is reportedly the explanation for reputed capital flights from Argentina in 1961 when the country experienced a recession. Shortages of conventional bank credit also create a high interest environment attractive to short-term lenders operating with speculative foreign funds, funds that flee the country when financial conditions stabilize and money is easier. Announcement of an international financial aid program to a Latin American country can, therefore, shake this type of money out of the country but it does not represent a true flight of locally-owned capital.

Quality of capital flight -- Permanent flight of capital represents an abdication of position by the upper income groups. Except in revolutionary circumstances such as occurred in Bolivia (after 1951) and Cuba (after 1959), no important rich groups have left Latin America permanently. Rather, they seek foreign exchange income from foreign operations that permit them to buy goods and services not available domestically, and over the long-run they probably use a considerable amount of foreign-earned profits to reinforce their economic and political positions at home.

Any recent permanent exodus of domestic capital, other than that from Bolivia and Cuba, probably represents the removal of social and economic elements that would not in any case contribute to the modernization of Latin America. Their departure may be cheap at the price.

Impact of capital flight -- Fundamentally, it is a loss confidence that sets off sizeable movements of flight capital. When that loss of confidence is widespread and the removal of capital is sufficient to bid up the price of hard currencies, there is a general inflationary impetus that can be adverse to the national economics. The relation of flight capital to inflows of foreign aid is less clearcut. The type of capital that readily flees to a safe haven is unlikely to be the same capital that would be otherwise available for development purposes. It is private money that has not been captured through taxes by the government and it is money that does not respond to local investment conditions. Healthy development within an orderly political environment and incentive tax program are among the ingredients needed to persuade capital to stay at home. Alliance programs already underway in a number of countries may provide the needed incentive.